Massachusetts Department of Telecommunications and Energy

Request For Comments	)	
On The Procurement Of Default	)	**D.T.E. 04-115**
Service Power Supply For Residential	)	
And Small Commercial And Industrial	)	
Customers	)	

COMMENTS OF CALPINE CORPORATION

Calpine Corporation ("Calpine") appreciates the opportunity to provide these comments to the Massachusetts Department of Telecommunications and Energy ("DTE") in response to its request for comments regarding the procurement of default service power supply for residential and small commercial customers.

Calpine owns and operates generating facilities throughout New England totaling approximately 1300 MW, including a 180 MW generating facility in Dighton, Massachusetts. Calpine is an active participant in both the wholesale and retail markets in Massachusetts and in New England. Calpine participates in the default service RFP's for both the residential and small commercial customers and the default service RFP's for large commercial and industrial customers.

Response to Request for Comments

The following reflects Calpine's responses to the questions raised by the DTE.

1. **Would smaller customers be better served if power supply for default service is procured using a portfolio of more than two solicitations? Please discuss the advantages and disadvantages of increasing the number of solicitations used to procure default service supply.**

Calpine supports an increase to the number of solicitations. Specifically, Calpine believes that smaller customers could benefit from an increase in the frequency of solicitations as well as from separate solicitations for default service inside and outside of the NEMA/Boston load pocket. In addition, Calpine recommends that the timing of solicitations be coordinated to minimize overlap with solicitations by other states for their standard offer and default service procurements.

While much of the state of Massachusetts is unconstrained and can be supplied from generators from all over New England, the NEMA/Boston load pocket is import constrained. In fact, beginning January 1, 2006, ISO-NE is planning to implement a locational installed capacity market that will distinguish NEMA/Boston as a distinct capacity pricing zone. Given these transmission limitations, only a portion of the NEMA/Boston local installed capacity requirement can be supplied by generators outside of that sub-area. In contrast, the rest of Massachusetts is not import constrained and may be supplied from all parts of the New England wholesale market. This means that more sellers may be well suited to compete for supply of the electric power needs of Massachusetts default service needs outside of the NEMA/Boston load pocket than are well suited to supply default service needs inside that load pocket. The advantage of providing separate solicitations for default service outside of the load pocket is that this should increase the number competing bids and decrease the risk premiums for offers to supply default service outside of the load pocket.[1] While this approach may highlight the

[1] Absent separate solicitations, all bidders must include a risk premium to reflect their cost exposure for supply inside NEMA/Boston. Further, in addition to locational wholesale price risk, load migration risk is increased if default service load outside the load pocket must pay an average price which exceeds the cost to supply their load.

higher costs of providing default service inside the load pocket, it would have no impact on the cost to procure that default service while it would allow a decrease in aggregate default service costs for Massachusetts.

Calpine believes that the increased quantity of load that will be served through default service post March 2005 warrants additional frequency in solicitations. Calpine recommends issuing solicitations four times per year with each solicitation procuring default service for 25% of the requirement for a one-year duration. Increasing the frequency of solicitations would provide smaller customers with the benefit of time-averaging of procurement prices and in turn stabilize prices over the solicitation period. For example, while a single procurement cycle may occur during a high price cycle (where fuel prices may have temporarily spiked), only 25% of the default service supply would be affected. While additional solicitations will increase administration responsibilities and expenses, the pricing benefits of increasing the frequency from two solicitations per year to four procurement periods per year should exceed any additional administration costs.

Finally, Calpine encourages the Commission to coordinate the schedule for the Massachusetts default service RFP's to avoid undue overlap with solicitations by other New England states. This will increase the number of bidders and hence the competitiveness of the bids. In preparing responses to RFPs, each bidder must consider its own unique set of financial assurance, human resource and supply hedging constraints. Overlapping RFP processes among the states may force some potential bidders to elect not to bid into the Massachusetts default service RFP because of constraints produced by overlapping bid solicitations, e.g. the combined financial assurance, human resource or

supply hedging requirements of the aggregate bid processes may preclude or limit participation. Even where the constraints are not limiting, overlap may increase the overall price of offerings required by bidders to offset the risk associated with being too successful (winning more bids than the bidder is positioned to supply). Accordingly, in order to increase competition in the bid process, lower risk and maximize the opportunity for lower bid prices, the Commission should establish an RFP process that avoids overlap with similar processes established in other New England states.

2. **Would smaller customers be better served if power supply for default service was procured for a term longer than twelve months? Please discuss the advantages and disadvantages of using supply terms greater than twelve months. In particular, please discuss:**
    a. **Whether longer term contract terms are likely to produce lower prices,**
    b. **How such an approach would affect price certainty and market efficiency,**
    c. **How such an approach could be tailored to accommodate customer migration to competitive supply.**

Given that smaller customers may choose to leave default service and take service from a competitive retail provider during the term of a default service supply contract, it makes sense to keep the duration of the contract at twelve months. Under this framework, it is unclear whether longer contract terms would produce lower prices. Notably, it is possible that a longer contract term might produce higher prices as a consequence of increased migration risk. For example, while a longer term contract would provide price certainty for a longer duration, default service customers may choose to leave during the term of the contract. This potential loss of customers may increase the risk to the seller

and potentially create a higher bid price given uncertainties created to revenues over the term given the customer loss.

In addition, longer durations increase the risk that underlying wholesale market policy may change during the term of the contract; these market policy changes may increase costs in a way that could not reasonably have been predicted. For all of these reasons, Calpine recommends maintaining the current twelve month duration. While the issue of longer contract terms may need to be revisited in the future in conjunction with resource adequacy and steps necessary to support new generator investment, these issues extend beyond the scope of default service procurement and encompass all classes of retail service. Calpine has elected not to raise those issues here.

3. Would smaller customers be better served if power supply for default service was procured on a statewide basis? Please discuss the advantages and disadvantages of using a statewide approach to default service procurement.

Smaller customers will be better served if there are more suppliers competing to supply default service. In response to prior questions, Calpine has recommended segmenting default service supply requirements into NEMA/Boston and rest of Massachusetts regions and minimizing overlap of Massachusetts default service RFP's with those of other New England states in order to promote competition. Applying a statewide approach to default service procurement in and of itself may have no impact on smaller customers. It really depends on the nature of the procurement policy whether administered individually at the distribution utility level or through a separate statewide process. Consider each of the following hypothetical objectives:

(i) If the Commission were considering pursuit of a statewide procurement to bundle all default service requirements under a single statewide RFP, this would preclude the benefits of bifurcating the procurement of default service for NEMA/Boston from that for default service outside of that subarea. Calpine has identified the benefits of bifurcating those purchases in prior responses.

(ii) If the Commission were considering pursuit of a statewide procurement to have a single staff to administer RFP's for the state versus continuing this effort at the utility level, it is not clear that smaller customers would experience lower costs. The existing staff at the distribution companies would likely not change and additional costs would need to be incurred to create and staff a new entity.

(iii) If the purpose of pursuing a statewide approach was instead to achieve uniformity in the manner of contracting for default service supply, whether smaller customers were advantaged or disadvantaged would depend on the policy uniformly adopted statewide.

While there may not be a need for a statewide RFP process, Calpine would encourage the Commission to require a single set of creditworthiness and financial assurance provisions applicable to all default service procurements state-wide. Such a policy would allow for uniformity and encourage the implementation of commercially reasonable credit provisions that encourage participation and competition as, for example, developed by the National Grid distribution companies and Fitchburg, Gas & Electric in their

default service procurement. We would encourage the Commission to require a single credit provision developed based upon the National Grid and Fitchburg, Gas & Electric policies.

4. **Would smaller customers be better served if power supply for default service was procured using an auction process (e.g., descending clock) rather than through requests for proposals? Please discuss the advantages and disadvantages of using an auction process to procure default service. In particular, please discuss whether using an auction is likely to produce lower default service prices.**

Smaller customers are better served through procurement of default service under a request for proposal (RFP) approach. Auctions are most typically useful in the sale or purchase of uniform products where the only differentiating factor is a single price component. In contrast, under an RFP process, all suppliers submit bids consistent with a uniform RFP, a short list of suppliers is developed and the distribution companies can finalize the terms and conditions in a manner that provides the best advantage to smaller customers. An auction process is a less flexible process to arrive at a single seller, provides for standardized rigid terms and conditions procedure and may miss the benefits available to smaller customers through the greater flexibility available under an RFP process.

For example, while it may be possible to structure a standard set of terms and conditions regarding the supply arrangement, it may turn out that fine tweaks in those terms and conditions would facilitate significant price improvements by certain of the interested suppliers. Such tweaks might address financial assurances, credit or wholesale market change risk and are more likely to occur in the RFP process than in the auction.

Further, in addition to the flexibility RFP processes provide, unlike an auction process where a supplier may submit higher bids initially only to wait to see what its competitors offer in subsequent rounds, the current RFP process requires all bidders to provide the best price they can in the only round. If they do not, they lose the bid. This dynamic places significant pressure on suppliers to underbid their competitors. They do not have the luxury of waiting to see how high they can keep their price without losing the bid to competing suppliers. Thus, RFP's provide better opportunity to produce lower prices for smaller customers.

5. **Although the term "default service" is statutory, G.L.c.164,1, it has confused some customers because of its intended suggestion of nonfeasance in performing a legal or contractual obligation. Is there some better or more descriptive term that ought to be used by distribution companies on and after March 2005.**

Given that the purpose of default service is to provide customers with a backstop electric supply in the event they do not choose a competitive retail supplier, Calpine suggests the DTE consider using the term "backstop service" in place of "default service".

Calpine appreciates the opportunity to provide these comments on default service procurement in Massachusetts and we look forward to future dialogue with the Commission on these and other issues.

Respectfully submitted,

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